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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

PERIODIC REPORTING (PROPOSAL FIVE)	Docket No. RM2022-11

PETITION OF THE UNITED STATES POSTAL SERVICE FOR THE INITIATION OF A PROCEEDING TO CONSIDER PROPOSED CHANGES IN ANALYTICAL PRINCIPLES (PROPOSAL FIVE)
(July 29, 2022)

Pursuant to 39 C.F.R. § 3050.11, the Postal Service requests that the Commission initiate a rulemaking proceeding to consider a proposal to change analytical principles relating to the Postal Service's periodic reports. The proposal, to update and improve the methodology for calculating the Contract Delivery Services (CDS) proportions used to estimate accrued CDS costs and the distribution key used to attribute these costs in Cost Segment 14, is labeled Proposal Five and is discussed in detail in the attached text.

Respectfully submitted,

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Proposal Five: Update Contract Delivery Service Accrued Cost Calculation and Distribution Key

Objective:

The objective of this proposal is to update and improve the methodology for calculating the Contract Delivery Services (CDS) proportions used to estimate accrued CDS costs and the distribution key used to attribute these costs. These goals are accomplished by analyzing the available data sources for the CDS cost proportions, investigating the relationship between CDS and rural mail distributions, and through the re-estimation of the affected highway transportation variability equations.

Background

CDS suppliers are independent contractors who provide delivery on specific routes not serviced by city or rural carriers. In response to the USPS Office of Inspector General (OIG) Audit Report Number 20-313-R21, the Postal Service initiated research on the estimation of accrued costs and product costs of CDS. Specifically, the OIG report recommended that the Postal Service undertake two tasks:

1. *Reevaluate the cost proportion percentages used to estimate accrued CDS costs; assess the possibility of using actual CDS payment data to calculate product costs; and, if deemed appropriate, submit a proposal to the PRC to update the costing methodology.*

2. *Conduct a study to determine whether similar mail volumes are delivered on CDS and rural routes; and, based on the results of that study, submit a proposal to the PRC to update distribution keys used to attribute CDS costs, if deemed appropriate.*[1]

The current treatment of CDS costs can be divided into three steps: 1) the identification of accrued costs; 2) the attribution of costs; and 3) the distribution of costs.

In the general ledger, CDS accrued costs are not separately identified. Instead, CDS accrued costs are included as a portion of different general ledger expense accounts contained in cost segment 14 (purchased transportation), components 143 (Highway) and 145 (Domestic Water). Primarily, these costs are reported in GL Account No. 53605 – Intra-CSD Regular (Intra-District) – and, to a lesser extent, Account No. 53601 – Intra-P&DC Regular. Costs in these two accounts comprise the overwhelming majority of all CDS costs and have a distinct treatment. To the extent that any CDS costs are accrued in other accounts, such as Inter-SCF and Domestic Inland Water, they are treated in the same manner as the non-CDS costs in those accounts.

The current calculation of volume variable CDS Intra-SCF costs relies upon two econometric analyses that were approved by the Commission in Dockets Nos. RM2016-12 (Proposal Four) and RM2021-1 (Proposal Seven). The CDS volume variability, like other highway variabilities, is calculated in a two-step process: 1) the development of a cost-to-capacity variability, and 2) the development of a capacity-to-volume variability. The resulting variabilities are then multiplied together to produce the overall volume

[1] *See* Contract Delivery Service Cost Attribution (Report Number 20-313-R21, dated June 21, 2021) at 8.

variability for the relevant contract costs. The aforementioned dockets presented updates to the capacity-to-volume and cost-to-capacity variabilities, respectively.

The Intra-P&DC and Intra-District account categories are made up of multiple transportation technologies and route types. Changes in either the individual variabilities for the transportation/route types or their relative proportions of the account category's costs can change the overall account category variability. Both account categories consist of the following four transportation/route types: box, city, van, and Tractor Trailer (TT). The unit of analysis is contract cost segments, which are apportioned to each grouping using the route type, number of boxes, vehicle capacity, and route number. Within each route/transportation type, the costs are summed to form the account category's cost proportions. The cost-to-capacity volume variabilities for the Intra-District and the Intra-P&DC accounts were individually estimated as the cost-weighted averages of the variabilities of the four transportation/route types. The fixed cost weighting proportions applied to the variabilities were last approved in Docket Nos RM2014-6 (Proposal Six) and RM2021-1 (Proposal Seven).

The distribution of the variable CDS costs in Intra-SCF accounts have been based on the Intra-SCF distribution factors estimated by the Transportation Cost System (TRACS) on a quarterly basis since it was first introduced.[2] CDS routes are not sampled in TRACS and therefore have utilized the Intra-SCF distribution factors as a reasonable proxy.

[2] The introduction of TRACS was discussed in the Opinion and Recommended Decision, Docket Number R90-1, January 4, 1991, Vol. I at III-154 - 164.

Proposal

The proposal is summarized below, but a full discussion of the research supporting the proposal is provided in a report, which is electronically attached to this Petition as a separate pdf file. Also provided separately, in USPS-RM2022-11-1, are the raw data, all statistical analyses, the calculation of the variabilities, a public analysis of the impact of the new variabilities and distribution key, and all associated documentation. A non-public analysis of the impact of the proposed methodological changes on cost proportions, accrued CDS cost, variabilities, and on product costs is provided under seal in USPS-RM2022-11-NP1.

Based on the results of the investigation of OIG Recommendation One, the Postal Service proposes that the GL Account No. 53605 and Account No. 53601 cost proportions be updated on an annual basis using TCSS data. In order to address this recommendation, the Postal Service has reevaluated the cost proportions using updated TCSS and Accounts Payable Excellence System (APEX) datasets. First, the cost proportions were recalculated using FY 2020 and FY 2021 TCSS data. The results are presented in Table 1. In the period between FY 2013 and FY 2021, several shifts in the cost proportions have occurred. In the Intra-P&DC account category, the percentage decreased for van routes and increased for TT routes, with smaller percentage increases occurring in box routes and city routes. These changes were largely captured by the update to the Intra-P&DC cost proportions in Docket No. RM2021-1. In the Intra-District account category, which has not received updated cost proportions since Docket No. RM2014-6, the percentages decreased for box routes and (to a lesser degree) city routes, while increasing significantly for TT routes and less so for van routes.

Table 1: Intra-PDC and Intra-District Cost Proportions using TCSS Data

Type	FY 2013	FY 2019	FY 2020	FY 2021
INTRA-PDC				
Box Route	1.1%	**1.6%**	1.6%	1.6%
City Route	8.6%	**8.8%**	9.2%	9.1%
Van	58.9%	**51.8%**	52.0%	51.2%
Tractor Trailer	31.5%	**37.8%**	37.2%	38.1%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**
INTRA-DISTRICT				
Box Route	**80.5%**	75.5%	75.1%	76.0%
City Route	**3.3%**	1.8%	1.7%	1.7%
Van	**14.4%**	14.9%	15.4%	15.3%
Tractor Trailer	**1.9%**	7.7%	7.8%	7.0%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: OIG_CDS_response_tables.xlsx
Note: Current approved percentages in bold.

The Postal Service has calculated the updated cost proportions using the Docket No. RM2021-1 methodology. This methodology was used for both the Intra-P&DC and Intra-District cost proportions and differs only slightly from the methodology used in Docket No. RM2014-6 where additional data cleaning was performed.[3]

The Postal Service also has assessed the feasibility of using CDS payment data from APEX to form the cost proportions for the Intra-P&DC and Intra-District account categories. APEX data do not contain the information necessary to apportion payments between all four transportation/route types, namely information on the vehicle capacity, which was a limitation recognized by the OIG that remains in place.[4]

While the cost proportions cannot be calculated using APEX data, the OIG also inquired about the feasibility of using the data to estimate accrued and volume variable

[3] *See* USPS RM2021-1-1, *INTRA PDC Variability Equations.sas.*
[4] *See Contract Delivery Service Cost Attribution* (Report Number 20-313-R21, dated June 21, 2021) at 8.

CDS costs. This methodology would serve as an alternative to the estimation method used by the Postal Service. Previously, the Postal Service compared the FY 2019 TCSS and APEX box/combination route costs and found significant discrepancies. Ultimately, the Postal Service determined that the APEX data did not "improve the quality, accuracy, or completeness of the data or analysis of data", which is the Commission evaluation standard.[5]

In response to OIG Recommendation Two, the Postal Service proposes that the rural cost distribution key (CS10, component 260) be used to attribute CDS costs to products. In order to investigate whether a more appropriate distribution key could be applied to CDS costs, the Postal Service first conducted a literature review of available CDS related materials. During the course of this investigation, it became apparent that both operational protocols and field observations support the hypothesis that similar mail volumes are delivered on CDS routes and rural routes.

The majority of CDS routes are box routes, which are focused on delivery, while the less frequent combination routes consist of both delivery and highway transportation activities. A comparison of documented duties confirmed that similar activities are performed by CDS contractors and rural carriers. Table 2 compares the activities of CDS suppliers, rural carriers, and Intra-SCF contractors, and demonstrates the similarities in activities between CDS suppliers and rural carriers and the differences from those performed by Intra-SCF contractors.

[5] See 39 C.F.R. § 3050.11(a).

Table 2: Activities of CDS Suppliers, Rural Carriers, and Intra-SCF Contractors[6]

Activities	CDS Suppliers	Rural Carriers	Intra-SCF Contractors
Case Mail	✓	✓	×
Deliver Mail	✓	✓	×
Collect Mail	✓	✓	×
Sell stamps	✓	✓	×
Collect postage dues	✓	✓	×
Perform mail markups	✓	✓	×
Collect on delivery	✓	✓	×
Making merchandise returns	✓	✓	×
Perform mail forwarding	✓	✓	×
Selling money orders	✓	✓	×
Transport mail between SCFs and post offices	×	×	✓

Further support for the similarities between CDS contractors and rural carriers is found in the process that exists for the conversion of CDS routes to rural routes in comparable offices. For comparable routes, cost comparisons can be conducted between CDS and rural routes based on a standardized form.[7] If a CDS route is eligible and the data indicate that it is advantageous from a financial or service perspective to the Postal Service for these deliveries to be conducted by a rural carrier, the route may

[6] *See Contract Delivery Service Cost Attribution* (Report Number 20-313-R21, dated June 21, 2021) Table 4 at 11.
[7] *See Management of Rural Delivery Services and Handbook EL-902, Agreement between USPS and National Association of Rural Letter Carriers, Article 32, Subcontracting*.

be converted from a CDS route to a rural route. This feature indicates that CDS routes may have similar volumes to rural routes because some rural deliveries were previously conducted by CDS contractors before conversion. These routes would have the potential to be sampled in the Rural Carrier Cost System (RCCS) after conversion were to take place.

The decisions of how to incorporate the boxes served is a local decision and may vary widely depending on local staffing and union agreements; for example, the CDS route may be parsed into geographical segments and added on to one or more established rural routes, an auxiliary route may be established or amended, or a new rural route may be established. CDS routes can be converted quite seamlessly to minimize the impact on operations, and identifying the original CDS route which may be fragmented afterwards presents a difficulty. In contrast, rural routes are typically not converted to CDS routes due to previous agreements.

Impact

In response to the USPS OIG Audit Report Number 20-313-R21, the Postal Service initiated research on the estimation of accrued costs and product costs of CDS. Based on this research, the Postal Service proposes two methodological changes to the treatment of CDS costs. One, the Postal Service proposes to update the Intra-P&DC and Intra-District cost proportions annually using TCSS data. Two, the Postal Service proposes that the rural distribution key be applied to attribute CDS costs.

An annual update of the TCSS cost proportions will significantly reduce the discrepancy between the Postal Service’s method for calculating accrued and volume

variable CDS costs and the OIG's method for calculating those same costs. This change will also improve the accuracy of CDS cost reporting. As previously mentioned, Intra-P&DC cost proportions were updated in Docket No. RM2021-1. Due to this update, the cost impact of applying the FY 2021 TCSS proportions is slightly blunted, as most of the impact is related to the updated proportions for Intra-District. As a result of the first part of this proposal, volume variable highway costs would increase by 0.03 percent during the initial update.[8]

The second part of the proposal would apply the rural cost distribution key (CS10, component 260) to CDS costs. In order to do so, the CDS costs would first need to be calculated and isolated. The appropriate volume variabilities would then need to be applied to the CDS costs and remaining costs in Intra-SCF accounts. Due to the changes in variability as a result of this proposal, volume variable highway costs are estimated to increase by $33.7 M, or 0.9 percent.[9]

After multiplying the appropriate variability, the rural carrier distribution key would be used to attribute the CDS costs to postal products. Utilizing this distribution key, Total Domestic Market Dominant Services would be attributed 0.2 percent of the total volume variable costs for highway transportation. Currently, the fact that CDS contractors handle special service activities is not accounted for in the Intra-SCF distribution key. With the application of the rural distribution key, highway costs for High Density and Saturation Flats/Parcels and In County Periodicals increased significantly. This increase, however, results in less than a $0.01 increase on a unit cost basis. Table

[8] *See* CDS Proposal - Public Impact Rec 1.xlsx
[9] *See* CDS Proposal - Public Impact Rec 2.xlsx

3 shows the difference in unit highway purchased transportation costs, using both the portion of Proposal Five relating to OIG Recommendation Two and the established methodology.[10]

Table 3: Highway Unit Cost Impact - Recommendation Two Portion

PRODUCT	Proposed Highway Unit Cost	Current Highway Unit Cost	Highway Unit Cost Difference
Single-Piece Letters	$ 0.021	$ 0.021	$ (0.000)
Single-Piece Cards	$ 0.010	$ 0.010	$ 0.000
Presort Letters	$ 0.009	$ 0.009	$ 0.000
Presort Cards	$ 0.007	$ 0.006	$ 0.000
Single-Piece Flats	$ 0.217	$ 0.222	$ (0.006)
Presort Flats	$ 0.077	$ 0.077	$ (0.001)
Total First-Class Mail	**$ 0.015**	**$ 0.015**	**$ (0.000)**
High Density and Saturation Letters	$ 0.001	$ 0.001	$ 0.001
High Density and Saturation Flats/Parcels	$ 0.003	$ 0.001	$ 0.002
Every Door Direct Mail-Retail	$ 0.000	$ -	$ 0.000
Carrier Route	$ 0.011	$ 0.009	$ 0.001
Letters	$ 0.005	$ 0.005	$ 0.000
Flats	$ 0.051	$ 0.051	$ (0.000)
Parcels	$ 0.157	$ 0.156	$ 0.001
Total USPS Marketing Mail	**$ 0.007**	**$ 0.006**	**$ 0.001**
In County	$ 0.002	$ 0.000	$ 0.002
Outside County	$ 0.049	$ 0.049	$ 0.000
Total Periodicals	**$ 0.043**	**$ 0.043**	**$ 0.001**
Alaska Bypass Service	$ -	$ -	$ -
Bound Printed Matter Flats	$ 0.052	$ 0.052	$ (0.000)
Bound Printed Matter Parcels	$ 0.092	$ 0.088	$ 0.003
Media/Library Mail	$ 1.038	$ 1.053	$ (0.015)
Total Package Services	**$ 0.274**	**$ 0.275**	**$ (0.002)**
US Postal Service	$ 0.094	$ 0.096	$ (0.002)
Free Mail	$ 0.131	$ 0.132	$ (0.001)
Total Domestic Market Dominant Mail	**$ 0.013**	**$ 0.013**	**$ 0.000**
Certified Mail	$ 0.040	$ -	$ 0.040
COD	$ 0.132	$ -	$ 0.132
Insurance	$ 0.006	$ -	$ 0.006

[10] The impact of the new variabilities and distribution key on competitive products are presented in the non-public file, CDS Proposal - Non Public Impact - Rec 2.xlsx in USPS-RM2022-11-NP1.

Registered Mail	$ 0.036	$ -	$ 0.036
Other Domestic Ancillary Services	$ 0.014	$ -	$ 0.014
Money Orders	$ 0.000	$ -	$ 0.000
Post Office Box Service	$ -	$ -	$ -
Total Domestic Market Dominant Services	$ 0.021	$ -	$ 0.021
Total Domestic Competitive Mail and Services	$ 0.289	$ 0.291	$ (0.002)
Total International Mail and Services	$ 0.196	$ 0.196	$ 0.001

The implementation of both aspects of the proposal using FY 2021 data results in a shift of $42.6M, or 1.2 percent, in highway costs from institutional to volume variable costs.[11] Competitive highway costs decrease by 0.02 percent under this proposal while Market Dominant costs increase by 2.5 percent.[12] Due to the application of the rural distribution key, highway costs for High Density and Saturation Flats/Parcels and In County Periodicals increase significantly on a percentage basis. This increase, however, results in less than a $0.01 increase on a unit cost basis. Approximately 0.2 percent of the volume variable costs for highway transportation would be attributed to Total Domestic Market Dominant Services under this methodology.

[11] *See* CDS Proposal - Public Impact Joint.xlsx

[12] The impact of the new variabilities and distribution key on competitive products are presented in the non-public file, CDS Proposal - Non Public Impact - Joint.xlsx in USPS-RM2022-11-NP1.